IN THE

Supreme Court of the United States

OCTOBER TERM, 1978.

No. 78-1054

SEALY, INCORPORATED, SEALY SPRING CORPORATION—INDIANA, SEALY SPRING CORPORATION—EAST, SEALY SPRING CORPORATION—WEST, SEALY MATTRESS COMPANY OF COLORADO, INC., SEALY MATTRESS COMPANY OF NORTHERN CALIFORNIA, INC., SEALY MATTRESS COMPANY OF SOUTHERN CALIFORNIA, INC., SCHNORR MANUFACTURING COMPANY, INC., SEALY MATTRESS COMPANY OF FLORIDA, INC., SEALY MATTRESS COMPANY OF PITTSBURGH, INC., SEALY MATTRESS COMPANY OF PHILADELPHIA, INC.,

Petitioners,

vs.

OHIO-SEALY MATTRESS MANUFACTURING COMPANY, SEALY MATTRESS COMPANY OF HOUSTON, SEALY MATTRESS COMPANY OF PUERTO RICO, INC., SEALY OF THE NORTHEAST, INC., AND SEALY MATTRESS COMPANY OF GEORGIA, INC.,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR RESPONDENTS IN OPPOSITION

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QUESTIONS PRESENTED

1. Can a defendant which, in its own words, devised "ways and means to get around the Supreme Court ruling [in *United States* v. *Sealy, Inc.*, 388 U.S. 350 (1967)] in such a way as to be able to retain the territorialization" obtain an overruling of that decision after 12 years of calculated noncompliance?

2. Should the long-standing distinction between horizontal and vertical territorial restraints which was recognized in *Sealy* and *United States* v. *Topco Associates, Inc.*, 405 U.S. 596 (1972) and recently reaffirmed in *Continental T.V., Inc.* v. *GTE Sylvania Inc.*, 433 U.S. 36 (1977) now be repudiated?

3. Would a holding in *ASCAP* v. *Columbia Broadcasting System, Inc.*, No. 77-1583, that it is not per se unlawful for copyright owners jointly to offer blanket licensing, so as to create a unique product which none can offer individually, require a drastic reformulation of the per se doctrine so as to permit a naked restraint such as horizontal market allocation?

4. Can a defendant which affirmatively agreed to a jury instruction stating that exclusive sales territories constituted a per se violation of the antitrust laws upset a jury verdict which was supported by substantial evidence of a Rule of Reason violation as stated in another agreed jury instruction?

STATEMENT OF THE CASE

The opinion below, reported at 585 F.2d 821 and appended to defendant's Petition for Writ of Certiorari ("P.App.," A1–A48), contains a careful discussion of the complicated factual and procedural history of this case. Little need be added to the description of the case presented by the Court of Appeals in order to explain why certiorari should not be granted.

This private antitrust suit was brought by a mattress manufacturer licensed by defendant to make and sell "Sealy" brand bedding.[1] As the opinion of the Court of Appeals

[1]Ohio-Sealy Mattress Manufacturing Company and its subsidiaries, plaintiffs-counterdefendants-respondents, are referred to jointly in the singular as "plaintiff" or "Ohio-Sealy." During the proceedings below plaintiff was sometimes referred to as "Ohio."

Defendants-counterplaintiffs-petitioners, Sealy, Inc. and its subsidiaries, are referred to jointly in the singular as "defendant." During the proceedings below defendant was at various times referred to as "Sealy, Inc.," "Sealy, Inc., et al.," "Sealy" and "National Sealy."

explains, plaintiff's cause of action was founded upon defendant's conduct in the aftermath of this Court's decision in *United States* v. *Sealy, Inc.*, 388 U.S. 350 (1967). There the Court held that defendant violated Section 1 of the Sherman Act, 15 U.S.C. §1, by allocating exclusive territories among its trademark licensees, who were also defendant's shareholders and most of whom were members of its Board of Directors. 388 U.S. at 353–54, 357–58.

On July 11, 1967, only twenty-nine days after the Court's decision in *Sealy*, defendant's licensee-directors met in Chicago to discuss the possible consequences of the decision. Shortly after the meeting, defendant's corporate secretary sent its general counsel the following letter:

> "Enclosed is draft of the minutes of last Tuesday's Board meeting. I know you thought quite comprehensive minutes should be kept and these are not very. My notes don't indicate any well-thought-out suggestions —merely speculation on ways and means of getting around the Supreme Court ruling in such a way as to be able to retain the territorialization. I don't think such meanderings would look well in the minutes.
>
> I am open to any suggestions, criticisms or amplifications on the draft.
>
> I will await word from you before proceeding with the issuance of these minutes."[2]

Although the original minutes of the July 11 meeting referred to were destroyed, documentary evidence, including notes taken by those present, and trial testimony confirmed that the purpose of the meeting had been as described by the corporate secretary. Exclusive territories were regarded by

[2]PTX 288, 1 App. 379. Record references containing the abbreviation "App." refer to the two-volume Joint Appendix filed by the parties below.

defendant as "a matter of life and death"[3] and beginning with the July 11 meeting, defendant embarked upon a program of calculated noncompliance with the decision of the Court.

Subsequent events (including defendant's replacement of the express provision for exclusive territories with a host of "lesser" restraints having the same effect) are fully described in the opinion of the Court of Appeals. 585 F.2d at 827–30; P.App., A10–A15. The Court of Appeals' discussion of those restrictions emphasizes that this was primarily a factual case regarding the existence, purpose and effect of defendant's conspiracy to "get around" the *Sealy* decision and thus achieve the same restraint of trade outlawed in that decision.

One point is made in defendant's Statement (and elsewhere in its Petition) which is highly misleading and requires correction here. Defendant attempts inaccurately to portray the Sealy licensees as weak firms competing against much larger rivals in unconcentrated national markets or, in defendant's words, as "[a] number of small local manufacturers unit[ing] to develop a uniform product in order to compete in a national market" (Petition, p. 11)—as "a group of manufacturers lacking market power" (Petition, p. 14). Nothing could be further from the truth.

In fact, the mattress business is highly localized because of the bulky nature of the product, the fact that retailers typically desire not to warehouse the product, and the need for frequent customer sales calls. Testimony at trial confirmed that a mattress manufacturer is unable to compete effectively beyond a two to three hundred mile radius from its plant.[4] Because of this and because product differentiation by brand name is extremely important, the local geographic

[3] 2 App. 94.
[4] 2 App. 522–23.

markets in which mattresses are sold are *highly* concentrated. The Sealy organization's share of certain markets ranges as high as 50%, the four-firm concentration ratios range to 85.5%, and the eight-firm concentration ratios range to 97.8%.[5] Of the 21 Areas of Primary Responsibility assigned to Sealy licensees, there are 15 such Areas in which the four largest firms account for 76% or more of sales.[6]

Thus, while it is true that the entire Sealy group accounts for approximately 20% of mattress sales nationally (making it by far the largest licensing group in the mattress industry), figures relevant to assessing the actual market power of the licensees in the markets where their products are sold demonstrate that the Sealy licensees are powerful factors in highly concentrated local markets. It is precisely under these circumstances that horizontal restrictions among actual or potential competitors have always been recognized as having the most pernicious effects.

ARGUMENT

REASONS WHY THE WRIT SHOULD NOT BE GRANTED

As will be shown, neither *Sylvania* nor *ASCAP* presents any justification for reconsidering the holding in *United States* v. *Sealy* that horizontal territorial restraints are unlawful per se. Moreover, even if there were reason to overrule *Sealy*, and there is not, this is not the case in which to do it. Here the defendant consciously defied the ruling in *Sealy*, the jury verdict was further supported by substantial evidence of a Rule of Reason violation, and the defendant affirmatively agreed to both the per se and Rule of Reason jury instructions.

[5] 1 App. 414.
[6] 2 App. 540.

1. The Court Should Not Grant Certiorari to Consider Overruling *United States* v. *Sealy* in a Case Where the Defendant Consciously Defied That Very Decision.

Ever since the jury returned its verdict in this case, after receiving *agreed* instructions which permitted the jury to decide the case on either a per se or Rule of Reason theory, defendant has employed a variety of gambits both in the District Court and in the Court of Appeals to try to upset that verdict, but the approach now being taken to try to persuade the Court to grant certiorari is by far the most audacious.

Having devised, in its own words, "ways and means of getting around the Supreme Court ruling [in *Sealy*] in such a way as to be able to retain the territorialization" and having been forced by this lawsuit to suffer the consequences of such wrongdoing, defendant now asks the Court to grant certiorari to overrule the *Sealy* decision so as to immunize its deliberate disobedience of the Court's ruling.

Respondents respectfully submit that defendant's defiance of *Sealy*, as documented in the Statement of the Case and in the Court of Appeals' opinion, should alone constitute compelling grounds for denial of the Petition.

2. The Court of Appeals Was Correct in Holding That *Sylvania* Provides No Basis for Overruling *Sealy*.

The primary argument advanced by defendant is that there exists a "fundamental inconsistency" between *Sylvania* and *United States* v. *Sealy* (and presumably the present case as well). Defendant argues that the Court, having held the Rule of Reason applicable to vertical territorial restrictions in *Sylvania*, is now obligated to reconsider the entire question of horizontal territorial restrictions. Yet, such restrictions

have been unlawful per se since the earliest days of the Sherman Act, and *Sylvania* expressly reaffirmed that "there is no doubt" that horizontal territorial restrictions "would be illegal per se . . ." 433 U.S. at 58, n. 28. The difference in treatment accorded vertical and horizontal territorial restrictions is long-standing and fully consistent with economic thinking. *See White Motor Co.* v. *United States*, 372 U.S. 253 (1963).

In *Sylvania*, the Court considered vertical territorial restrictions imposed by a manufacturer accounting for "a relatively insignificant 1% to 2% of national television sales" (433 U.S. at 38) on distributors of its products. In concluding that these restrictions were not per se offenses, the Court emphasized that vertical territorial restrictions may in some circumstances have unique justifications which would be absent where territorial restrictions had been imposed horizontally by agreement among actual or potential competitors. 433 U.S. at 54–56.

Among other reasons why vertical restrictions may be less dangerous than horizontal restraints, the Court noted the economic argument "that manufacturers have an economic interest in maintaining as much intrabrand competition as is consistent with the efficient distribution of their products" (433 U.S. at 56). Competitors, on the other hand, have every incentive to insulate themselves from competition, as defendant's licensee-directors sought to do so in the instant case.

Territorial restrictions imposed by agreements among competitors have long been regarded as per se violations of the Sherman Act. *Addyston Pipe & Steel Co.* v. *United States*, 175 U.S. 211 (1899); *United States* v. *National Lead Co.*, 332 U.S. 319 (1947); *Timken Roller Bearing Co.* v. *United States*, 341 U.S. 593 (1951); *Northern Pacific R. Co.* v. *United States*, 356 U.S. 1 (1958); *Citizen Publishing Co.* v. *United States*, 394 U.S. 131 (1969); *United States* v. *Topco Associates, Inc.*, 405 U.S. 596

(1972). Moreover, horizontal territorial restrictions have properly been condemned as unlawful per se, regardless of whether imposed by persons selling products under a shared trademark, as here and in *Timken* and *Topco*, or by persons selling products under their own trademarks.[7]

As the Court of Appeals stated (585 F.2d at 830–31; P.App., A15–A17), there is no inconsistency between *Sylvania* and this and other cases involving horizontal territorial restrictions. In the absence of any such inconsistency or, indeed, any conflict among the Circuits with respect to the per se illegality of horizontal territorial restrictions, defendant has presented no compelling reason why certiorari should be granted solely for the purpose of reexamining settled and sound principles of antitrust law.

[7]Throughout its Petition, defendant repeatedly suggests that historically a distinction has been drawn, and logically should be drawn, between "intrabrand" and "interbrand" competition, asserting at pp. 12–13 that "[t]he proper domain of the per se rule against horizontal market divisions is illustrated by *Timken Roller Bearing* v. *United States*, 341 U.S. 593 (1951), where independent competitors divided the market into exclusive territories so as to achieve the same effects as a price-fixing agreement—the elimination of interbrand competition." What defendant overlooks is that in *Timken*, as in *Sealy*, the independent competitors who divided markets were persons sharing a common trademark. *United States* v. *Sealy*, 388 U.S. at 356, n. 3. The fact that in each case the competition was in some sense "intrabrand" was properly considered irrelevant by the Court.

Historically, the distinction between "intrabrand" and "interbrand" competition has been drawn only for purposes of analyzing *vertical* restrictions, as in *Sylvania* and *White Motor*. That distinction, however, makes little sense in the context of *horizontal* restraints. If it were accorded importance for purposes of the Sherman Act, competitors could insulate themselves from antitrust liability merely by agreeing to sell their products under a common name. The important distinction, as *Sylvania* makes clear, is not whether the territorial restriction affects "intrabrand" or "interbrand" competition but rather whether it is vertical or horizontal.

3. The *ASCAP* Case Does Not Compel Reexamination of the Per Se Rule as Applied to Horizontal Territorial Restraints.

Defendant's second reason why certiorari should be granted is that the pendency of the *ASCAP* case[8] "compels" a broad reexamination of the per se doctrine as traditionally applied to many categories of horizontal restraints, including horizontal agreements to divide markets. In a gross distortion of the Solicitor General's position, defendant argues that the Brief for the United States as *Amicus Curiae* in that case, urging reversal of the decision below, is sympathetic with such drastic revamping of established antitrust doctrine.

ASCAP is, in many respects, *sui generis*, and regardless of how that case is decided, it will have no bearing on the generally applicable standard for testing horizontal territorial restraints. *ASCAP* involves an arrangement under which copyright owners sell blanket licenses to large users who thereby receive a product distinct from what individual copyright owners offer and thus avoid prohibitively high transaction costs in obtaining the use of copyright materials. Whether it is decided that the ASCAP arrangement is to be subject to the per se doctrine or to the Rule of Reason would have no effect on the disposition of the instant case.

As the *Amicus* Brief for the United States makes clear, the rationale for invoking the Rule of Reason in *ASCAP* is that an arrangement by which competitors provide "a product or service fundamentally different from anything any of them individually could market" is simply not price fixing or any other type of restraint that has ever been categorized as unlawful per se. (Brief for the United States, pp. 14–15.) Although the Solicitor General urges Rule of Reason analysis

[8]*Broadcast Music, Inc.* v. *Columbia Broadcasting System, Inc.*, No. 77-1578; *American Society of Composers, Authors and Publishers* v. *Columbia Broadcasting System, Inc.*, No. 77-1583.

in *ASCAP*, nothing in his Brief suggests that he favors wholesale abrogation of the per se doctrine so as to permit the attempted justification of naked restraints, such as horizontal territorial restrictions.

To the contrary, the Solicitor General emphasizes that in certain instances "[i]t is better to declare the entire category of restraints unreasonable *per se*, not only to avoid exhaustive market assessments in every case but also to provide clear guidelines for antitrust compliance," citing *United States* v. *Topco*, *supra*, the Court's most recent decision declaring horizontal territorial restrictions unlawful per se. (Brief for the United States, p. 14.) Also cited by the Solicitor General as illustrative of cases to which the per se doctrine applies is *Addyston Pipe* v. *United States*, *supra*, the first in a long line of decisions of the Court to consider horizontal territorial restrictions. (*Id.*) In short, the position taken by the Solicitor General in *ASCAP* is wholly consistent with the Court of Appeals' decision below and provides no support for defendant here.

ASCAP involves issues wholly distinct from those arising in this case. Even assuming, as defendant prematurely does, that the decision of the Second Circuit will be reversed, such a result would not warrant—much less "compel"—the grant of certiorari here in order to undertake a reexamination of the per se rule as applied to horizontal territorial restraints.

4. Even if *Sealy* Were to Be Reconsidered, This Is Not a Proper Case for Doing So Because the Verdict Is Supported by Substantial Evidence Relating to Alternative Rule of Reason Instructions and Because the Per Se and Rule of Reason Jury Instructions Were Agreed Upon.

Even if the Court were inclined to reconsider the applicability of the per se doctrine to horizontal market allocation arrangements, there are several reasons why the present case would be a most inappropriate vehicle for doing so.

In the first place, much evidence was presented at the trial concerning the unreasonableness, singly and in combination, of the various devices utilized by defendant to continue exclusive territories after the Court's decision in *Sealy*. Willard F. Mueller, who had been for many years the Chief Economist and Chief of the Bureau of Economics of the Federal Trade Commission and who testified as an expert witness for plaintiff, exposed the basic fallacies in proffered economic justifications for each of the restraints implemented by defendant after the *Sealy* decision. These restraints included so-called "passover payments" (ostensibly intended to avoid "free-riding"), excessive warranty repair charges, exclusive manufacturing territories, location clauses, and defendant's right of first refusal to purchase licensees. Dr. Mueller also testified extensively regarding the concentration of the mattress industry and the effects of the challenged restrictions.[9]

This economic evidence contrasts with the trial record in *United States* v. *Sealy*, where the Government proceeded on a per se theory and offered no economic evidence as to the unreasonableness of the restraint. The jury in the case at bar received both per se and Rule of Reason instructions, which defendant agreed to, and, as the Court of Appeals concluded,

[9] 2 App. 508-97. Considerable evidence in the record here concerning the market power of the Sealy licensees demonstrates that this would not be a suitable case for allowing the defendant to attempt to justify the challenged horizontal restraints. A far stronger case for condemnation of territorial restrictions is thus presented here than existed in *Topco*, where members of the Topco association lacked any significant market power. As the Court noted, Topco members' shares of sales in their respective areas ranged from only 1.5% to 16%, with the average being only approximately 6%. 405 U.S. at 600.

the record contains sufficient evidence for the jury to have found an antitrust violation under the Rule of Reason alone. 585 F.2d at 831; P.App., A17. There is no basis whatever for assuming that the result would in any way be different if this case were to be retried without per se instructions, and for that reason this is not a proper case for the exercise of discretionary jurisdiction.

A further reason why this case fails to present an appropriate vehicle for reconsidering the applicability of the per se doctrine to horizontal territorial restraints is defendant's failure to have raised this broad question in the District Court. At no time in the District Court did defendant even intimate that it was challenging the basic premise underlying *United States* v. *Sealy*. To the contrary, defendant *agreed* to both per se and Rule of Reason jury instructions, and it based its defense at trial both on denials that it had sought to perpetuate territorialization in defiance of the *Sealy* decision and on the asserted reasonableness of its restrictions.

Only after the jury verdict did defendant first question the per se instruction to which it had agreed. Defendant unsuccessfully argued to the Court of Appeals that *Sylvania* required reversal of the jury verdict. 585 F.2d at 830–31; P.App., A15–A17. Defendant not only renews this argument in its Petition but also for the first time in this eight-year-old litigation asserts that *United States* v. *Sealy* was incorrectly decided.

If defendant wished to take exception to the reasoning of *United States* v. *Sealy*, it could and should have done so at the outset of this case. Had objections been made to the per se instructions given to the jury, such objections could easily have been cured at that stage by the device of a special verdict or interrogatories. In view of defendant's having failed

to challenge the principle of the *Sealy* decision at the trial and having affirmatively agreed to instructions on both the per se and Rule of Reason theories, it would be manifestly unfair to plaintiff now to allow defendant to challenge the holding of *Sealy* on the pretext that *Sylvania* somehow makes a reevaluation of *Sealy* desirable.

CONCLUSION

For the foregoing reasons, the Petition for Writ of Certiorari should be denied.

Respectfully submitted,

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